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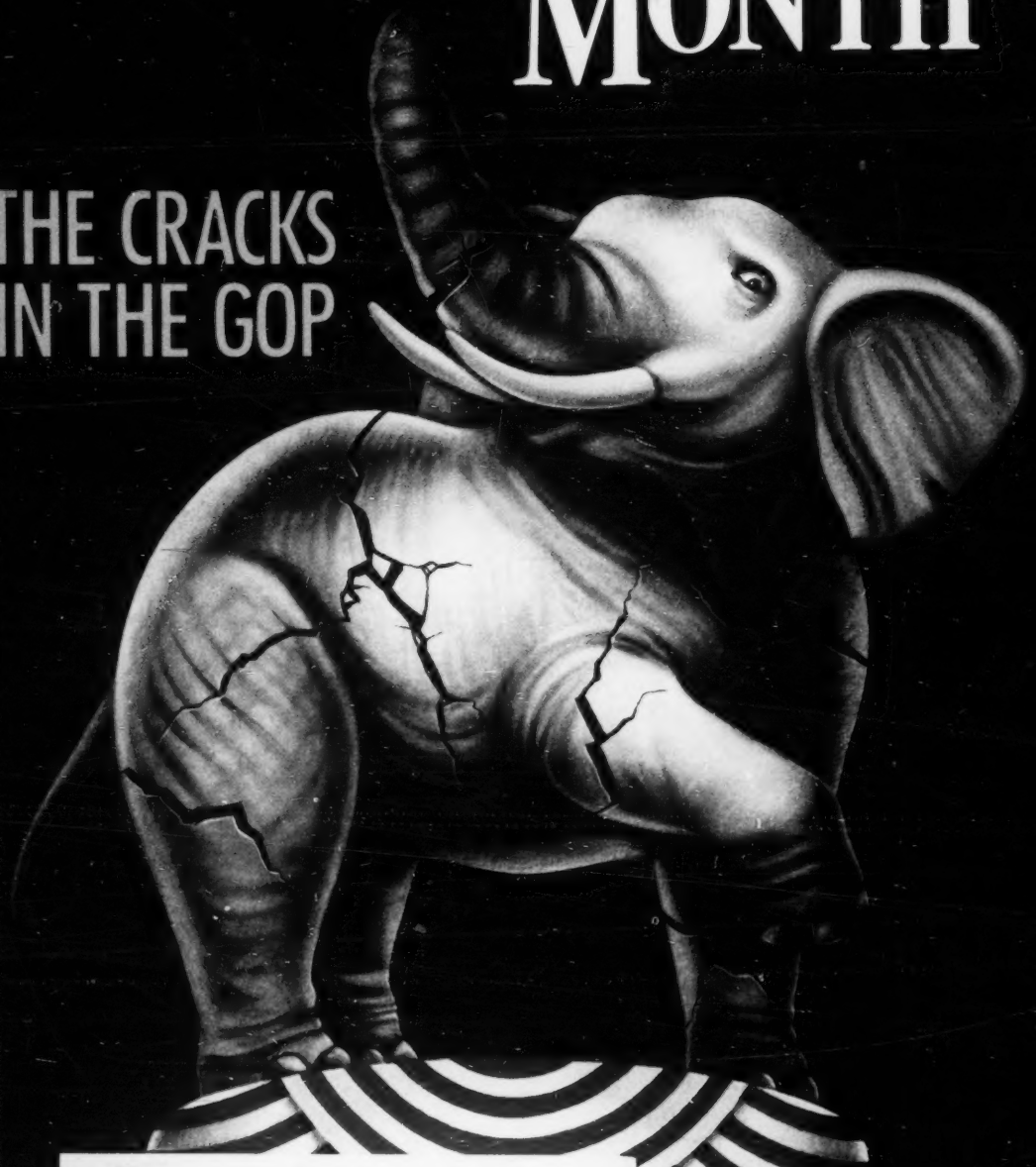
DUN'S BUSINESS MONTH

The Dollar Will Dive Again

THE CRACKS IN THE GOP



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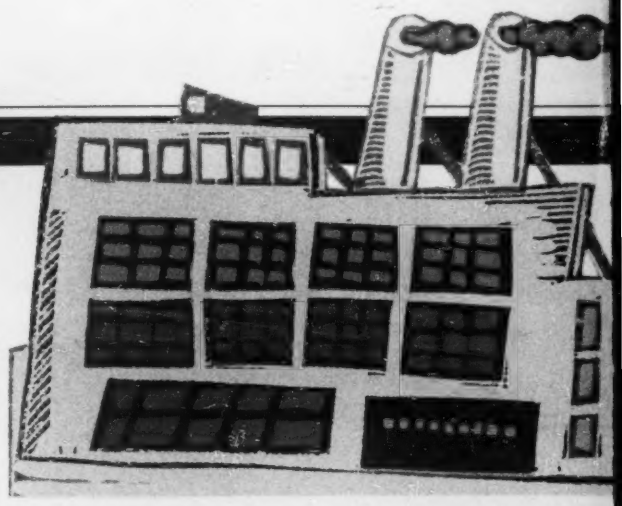

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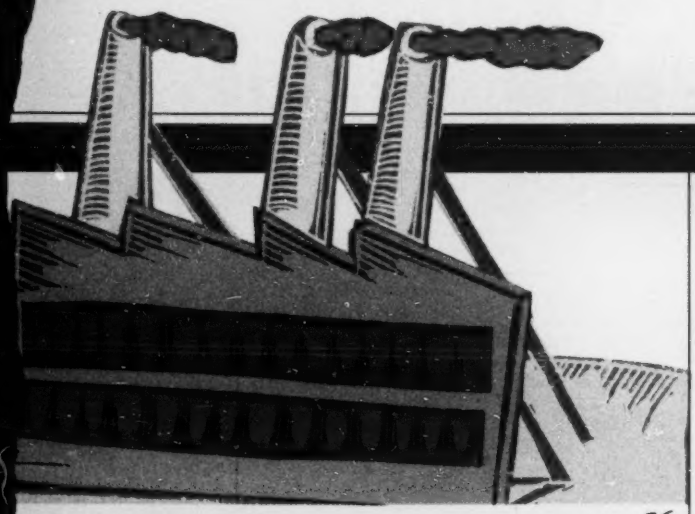

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Farm Crisis: The Worst Is Yet To Come

Grain prices will fall further and more farmers will leave, before U.S. agriculture recovers in the early 1990s.

by Lynn Adkins

U.S. grain farmer: His debt level will be the key to his survival

Bruce DeRaab surveyed the eight years of sweat and heartache he plowed into his Prairie City, Iowa, livestock and grain farm as the auctioneer raised the bullhorn to begin the sell-off. The lanky, 31-year-old farmer had been lured into farming when commodity prices were skyrocketing and the prospect of worldwide grain shortages appeared a certainty. Now, he can no longer stay afloat and is calling it quits.

DeRaab's plight is typical of a generation of young farmers, who borrowed heavily to buy acreage during the heady days of high grain prices in the mid-1970s. Since then, prices and profits have plummeted and some 650,000 farmers like DeRaab have gone belly up.

This shakeout is far from over. Before it ends, today's low prices will drop even more and government farm program spending will soar. The banks and the federal government will become owners of farmland that nobody else wants. There's no quick fix on the horizon for what's ailing the farmers. "It will take four to five years before exports return and profits are restored," says the eminent D. Gale Johnson, professor of economics at the University of Chicago.

Today the world is awash in grain, and prices languish at bargain-basement levels. U.S. farmers are giving back the gains (and more) that they reaped during the late 1970s and early 1980s when U.S. farm policy provided generous subsidies and, in effect, set floor prices artificially high, not only here but abroad. Coupled with the strong U.S. dollar, nations that were former importers were enticed to become grain producers and, in some cases, even exporters.

The farmers have also been hurt by economic forces outside their control. For instance, they are getting little help from the recent decline in the U.S. dollar. The currencies of America's major competitors—Canada, Argentina and Australia—have fallen even more than the dollar, making their grain cheaper than Uncle Sam's. And the biggest potential buyers of grain are the world's poorest and most debt-ridden nations, which must pay off their debts and earn U.S. dollars before they can buy more again.

America's new farm policy—enacted last December—recognizes the new competitive realities of the world grain market. It lowers the subsidies the government pays, which will drive

PHOTOGRAPH BY BOB BROOKS/IMAGE BANK

down U.S. grain prices, making them more competitive. "The farm bill serves notice to the world that Uncle Sam has declared a grain war," says ag economist Raymond Daniel, Chase Econometrics, Inc.

Indeed, over the next few years grain prices are likely to go through the floor. Abner W. Womack, professor of agricultural economics at the University of Missouri, expects wheat to drop from the current $3.12 a bushel to as low as $2.30 in the 1988-89 crop year. He sees corn plunging from the current $2.37 a bushel to $1.82 by 1988-89 and soybeans falling from $5.28 a bushel to $4.85 in 1987-88.

But sliding grain prices will trigger a mass exodus of farmers from the farm. Farmers today owe a whopping $200 billion; and between 60% and 75% of that debt, according to Neil Harl, agricultural economics professor at Iowa State University, is loaded on the backs of about 600,000 farmers. Whipsawed between low prices and high debt, about 300,000 farmers will leave, forecasts Chase Econometrics' Daniel, and the ranks of farm owners will shrink from 1.8 million to 1.5 million by the end of the decade.

Unlike past farm shakeouts, however, which weeded out the inefficient, this go-round, says economist Paul Justis of Control Data Corp.'s Agricultural Information Service, "it's not a question of size or efficiency; it's a question of debt."

Like DeRaab, the preponderance of victims will be less than 45 years old. This age group entered farming during the 1970s, when returns were unusually high—12%-to-13% versus 2%-to-3% today. And they borrowed heavily to buy acreage when land prices had spiraled upwards. But now farmland has plummeted in value—on average 45% since 1980. "These are the young tigers who are well educated, progressive and very efficient. Unfortunately, many are carrying too much debt," Justis notes.

But forcing farmers out of business won't bring down grain supplies by itself. The number of acres in production must shrink as well. Last year's farm legislation will take 45 million acres of cropland—10% of America's 450 million total tilled acres—out of production over the next five years, but that will only be the beginning. As land prices drop further, the laws of economics will probably pare tilled acres by another 10%. Economics will find other more profitable use, such as grazing land or mobile-home parks, for marginally-productive farmland.

Despite the cheap prices forecast for grain, profits will return, says agricultural consultant John A. Schnittker. "We are headed for an agricultural sector in which the farmer can make money on $2-a-bushel corn."

How? Unlike the unremitting downward spiraling of farm income during the Great Depression, this time government aid will prop up the farm economy. Farmers will get 38%-to-45% of their total income from government payments, and that income alone will cover many of their costs, according to Chase Econometrics' Daniel.

Farm costs will decline as well. The survivors will enjoy cheap energy, cheap fertilizer, better yields and very low debt levels to service. Also, the farmer's biggest fixed cost—land—is projected to remain at depressed levels or decline even further and then to stay at those levels for the next four to five years. The title to cropland will revert to the lenders—the federal government, banks and insurance companies. And because these institutions will be unable to unload the land, they will rent it out to the surviving farmers. As a result, Daniel estimates that by 1995, 70%-to-80% of American farmers will merely rent land or work for farm management firms.

That prospect worries those who remember the destruction wrought by absentee ownership in the past. By overworking the land, absentee owners of the great coffee plantations of Africa, the sugar plantations of Cuba and much of Europe's tillable acres during the Middle Ages, destroyed that land for decades. "The separation of the ownership of the land from the tiller of the land is not healthy," says Chase Econometrics' Daniel.

Still, only a handful of pessimists expect the 1990s to replicate the 1930s. "By 1990," predicts James Houck, agricultural economics professor at the University of Minnesota, "the promise of the farm policy will be realized and those export markets will be regained." The forces are in place for a recovery, but, "we've got to give the farm bill time to work," says John Urbanchuk, director of the International Agriculture Department at Wharton Econometric Forecasting Association." Then, Donald Paarlberg, Purdue University agricultural economist, expects "a greater percentage of this smaller group of farmers will be in a better financial position in years to come than in the past." ■

GRAIN PRICES GOING DOWN

Before prices of wheat, corn and soybeans rebound in the early 1990s, they will plunge even further.

CROP	1985–86	1988–89	1991–92
Wheat	$3.12	$2.30	$2.60
Corn	2.37	1.82	2.29
Soybeans	5.28	4.84	5.73

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INVESTMENT UPDATE

Here's the current status of a number of investments, and a look at how they have fared over the past month and the past year.

INVESTMENT	(7/31/86) Recent Price or Yield	Value of $10,000 if invested: Month Earlier	Year Earlier
Common Stock (Index fund, capital gains and dividends reinvested)	$25.77/share	$9,426	$12,452
per cent change		−5.7%	+24.5%
Bonds (30-yr., 11¾% Treasury Bond)			
MARKET VALUE	$134.63	$9,863	$12,604
ACCUMULATED INCOME		$72	$1,100
TOTAL		$9,935	$13,704
per cent change		−0.1%	+37%
Money Market Fund	6.02%	$1,051	$10,706
per cent change		+ 0.5%	+7.1%
Gold (Krugerrands)	$362.70/oz.	$10,422	$11,061
per cent change		+4.2%	+10.6%
HOUSE PRICES	**Recent**	**Month Earlier**	**Year Earlier**
Existing House	$107,900	$108,500	$95,700
per cent change		−0.5%	+12.7%
New House	$112,300	$122,100	$119,200
per cent change		−8.0%	−5.7%

Sources: Vanguard Group Inc.; Salomon Brothers; Donoghue's Money Fund Report; Manfra, Tordella & Brookes,Inc.; Federal Home Loan Bank Board.

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union members. It now operates 24 cash-and-carry warehouses in California, Arizona, New Mexico, Virginia and Maryland. Engemann expects earnings of $1.25 per share this year, $1.70 in 1987, and believes the stock could go from its recent 40 (for "exceptional companies" like Price, he says, he will break his P/E rule) to 67 over the next fifteen months.

Among even smaller companies, Engemann likes Green Tree Acceptance Inc. "No one's ever heard of them because they're in such a specialized business, providing mortgages for mobile homes," he says. "Very few companies want to get into this business because the average mortgage is only $16,000. So Green Tree has most of it to itself, and they're growing like crazy." Over the last three years, Green Tree has tripled its earnings. This year, Engemann expects nearly $2.50 per share, and $3 in 1987.

Newport Corp., another small and relatively unknown company, makes tables for high-precision instruments such as lasers. With its new table for the semiconductor manufacturing market (which, contrary to conventional wisdom, Engemann expects to resume faster growth soon), Engemann thinks Newport's fiscal 1986 earnings of 75 cents per share will rise to $1.20 next year.

He also likes Electro Rent Corp., which rents scientific instruments to large companies and should benefit from tax reform. The elimination of the investment tax credit will induce more companies to rent than buy, Engemann says. Electro Rent's earnings should hit $1.35 per share this year and $1.60 next year. "If this scenario turns out as we expect, you can double your money on the stock by the end of 1987," he says.

Pic 'N' Save Corp. "thrives on the mistakes of the free-enterprise system," as Engemann puts it, by buying and reselling the discontinued and discarded merchandise of manufacturers. Engemann's forecasts: $1.25 per share this year, $1.65 next year for a 71% total return on the stock.

—THOMAS J. MURRAY